$.24 per call rate to prior compensation periods (*i.e.*, the Interim Period *and* the Second Report and Order Period) is even warranted, as a matter of equity.

In its comments and reply comments on the RBOC proposal, APCC showed that, at least for independent PSPs, it would not be equitable to apply the $.24 rate retroactively to 1998 call volumes, for purposes of either Interim Period or Second Report and Order Period compensation.[5] APCC argued that, at least with respect to the compensation received by independent PSPs, the equitable solution -- one that will also avoid imposing huge administrative burdens on the parties and the Commission -- is to rule that there will be no compensation adjustments for *either* the Interim Period *or* the Second Report and Order Period. The additional information submitted herewith further confirms the validity of APCC's position.

Discussion

In its comments on the RBOC proposal, APCC explained that utilizing actual 1998 compensation payments as the basis for 1996-97 Interim Period adjustments would be patently inequitable because independent PSPs were uncompensated in 1998 for a huge volume of compensable dial-around calls. First, LECs and interexchange carriers ("IXCs") spent the Interim Period – during which LECs and IXCs were supposed to implement the system for call tracking – bickering over how to implement the Commission's call tracking requirement. The Commission ultimately ruled that LECs must implement FLEX ANI, but not before the Commission had to waive the October 7, 1997 implementation deadline. There were then massive problems experienced by independent PSPs with (1) LEC implementation, and IXC processing, of FLEX ANI codes that are supposed to "tag" payphone calls so that IXCs can track and pay for the calls.[6] Second, PSPs experienced massive problems identifying and collecting compensation from "switch-based" resellers who are supposed to be responsible for paying compensation under the FCC rules.

Since filing its comments on the RBOC proposal, APCC has compiled more complete information on the average volume of ***actually compensated calls***, per payphone per month, for independent PSPs. For 1998, payphones for whom APCC's compensation clearinghouse affiliate collects compensation, representing close to three quarters of all independent payphones, have been paid dial-around compensation for an average of 109 calls per month. As discussed below, that number is far below the call volume that the Commission assumed was necessary in order to recover the costs allocated to dial-around calls. Accordingly, APCC's payment data confirms that applying the current $.24 rate to 1998 call volumes, so as to retroactively adjust the compensation received for the Interim

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5 The equities may differ between ILEC PSPs and independent PSPs. But independent PSPs have many equities in their favor. *See*, e.g., note 9 below.

6 The LEC PSPs did not experience the same problems because most of their payphone lines transmitted hard coded payphone identifiers as part of the legacy of past discrimination against independent PSPs.

Period and for the Second Report and Order period – would result in systematic undercompensation of independent PSPs.

The significance of this shortfall is easily demonstrated. The Commission set the $.24 rate in the *Third Report and Order* based on its analysis of the per-call cost of maintaining a payphone in a "marginal location." The Commission sought to "ensure that the current number of payphones is maintained," and concluded that "the default per-call compensation amount we establish should ensure that each call at a marginal payphone location recovers the marginal cost of that call plus a proportionate share of the joint and common costs of providing the payphone." *Third Report and Order* at 2571. The Commission determined that "establishing a compensation amount that allows a PSP to recover its costs will promote the continued existence of the vast majority of payphones presently deployed, thereby satisfying what we consider to be Congress's primary directive that we ensure the widespread deployment of payphones." *Id.* at 2579.

The Commission found that the joint and common costs of a payphone at a marginal location totaled $101.29, and that an average of 439 calls (of all types) per phone per month are made from payphones at marginal locations. Dividing $101.29 by 439 yielded per call joint and common costs of $.231. Adding $.009 per call of costs specific to dial-around calls yielded a total of $.24 per call – adjusted to $.238 for purposes of retroactive compensation. *Third Report and Order* at 2632.[7]

The Commission's determination that a $.24 (or $.238) rate would ensure recovery of the costs of a marginal payphone was thus based on its determination that marginal payphones have 439 calls per payphone per month. *Third Report and Order* at 2612. Of these 439 calls, the Commission found that an average of 142 calls were dial-around calls (the rest are primarily coin calls). Id. at 2614, n. 302. The Commission thus expected that, to enable a payphone in a marginal payphone location to recoup its monthly joint and common costs, the payphone would generate an average of 142 dial-around calls, producing dial-around revenues of 142 x $.238, or $33.80 per month in dial-around compensation. The Commission reasoned that if PSPs operating payphones in marginal locations were compensated for all 142 of the dial around calls at a rate of $.238, then they would be able to recover their monthly costs, thereby ensuring "that the current number of payphones is maintained."

As the attached information on compensation payments makes clear, however, payphones at marginal locations have actually received compensation on far fewer than 142 calls per month. As noted above, the actual dial-around compensation payments in 1998

---

7 For purposes of retroactive application, however, the Commission stated that the rate would be $.238, because $.002, representing Flex ANI costs, would only be incurred for a three year period, on average, and therefore would only be recoverable prospectively, for three years beginning on the effective date of the order. *Third Report and Order* at 2635.

to the *average* APCC client payphone compensated the PSP for only about 115 calls per payphone per month.

Determining the impact of this shortfall on retroactive compensation adjustments is a matter of simple arithmetic. APCC's data on actually compensated calls relates to the *average independent payphone, not marginal payphones*; therefore, the proper comparison is between the 109 *compensated* calls at the *average* payphone and the number of *compensable* calls at an *average* payphone. The Commission found that *average* RBOC payphones generated 155 compensable calls per month (*id.* at 2614), which confirms APCC's survey-based estimate that the *average* independent payphone had 159 compensable dial-around calls per month. Thus, it is reasonable to conclude that in 1998 independent PSPs were compensated, on average, for only 109 out of 159 compensable calls per month, or 68.6% of compensable calls.

To translate this shortfall into the terms of the Commission's marginal payphone policy is also a simple matter. Given that the *average* independent payphone was paid on only 68.6% of compensable calls per payphone per month, it is reasonable to infer that a *marginal payphone* was paid on a comparable percentage of calls. Applying this percentage to the monthly call volume of 142 calls for marginal payphones yields a paid call volume for marginal payphones of about 97 calls per payphone per month, for total compensation of $27.55 per payphone per month (at the 1998 rate of $.284 per call). This is substantially lower than the $33.80 per month required by the Commission's analysis in the *Third Report and Order*. If the current $.238 rate is applied retroactively to 1998 call volumes, as proposed, the undercompensation of PSPs would become even worse (97 x $.238 = $23.09 per payphone per month).

To achieve the $33.80 per payphone per month cost recovery intended in the *Third Report and Order*, adjusted compensation for the Interim Period and Second Report and Order Period, if based on actual call volumes, would have to *exceed* substantially the *Second Report and Order* rate of $.284 per call ($33.80/97 = $.348).

Under these conditions, a retroactive adjustment based on the current rate of $.238 per call would be grossly inequitable, particularly because the causes of the shortfall in compensated calls are beyond independent PSPs' control. As noted in APCC's comments, the difference between actual and expected compensation payments results largely from massive problems experienced by PSPs with (1) LEC implementation, and IXC processing, of FLEX ANI codes that are supposed to "tag" payphone calls so that IXCs can track and pay for the calls; and (2) identifying and collecting compensation from "switch-based" resellers who are supposed to be responsible for paying compensation under the FCC rules. These problems have been amply documented to the Commission. Indeed, in the *Third Report and Order*, the Commission specifically acknowledged the reseller issue in explaining its decision *not* to include in the compensation rate an allowance for uncollectables, and stated: "It appears that if we were to grant such a petition, uncollectibles would be significantly reduced." *Id.* at 2619. The Commission also recognized that uncollectables are directly relevant to the issue of retroactive compensation:

> We note that, in a forthcoming order, we will determine the amount that IXCs owe PSPs for the period before October 7, 1997 and the way in which IXCs may recover overpayments that result from the default compensation amount established herein. If a petition for clarification is resolved prior to the adoption of our order addressing IXCs payments prior to October, 1997, we may visit the issue of uncollectibles in that order.

Id.[8]

Under the circumstances, the Commission must find that applying the $.238 rate to the Second R&O Period, or to the Interim Period based on Second Report and Order Period call counts, would disserve the paramount Congressional objective of sustaining widespread payphone deployment, because PSPs, who only received compensation for 68.6% of the compensable calls they handled, would ultimately receive on average $23.09 per marginal payphone per month, rather than the $33.80 the Commission determined was necessary for PSPs to satisfy their monthly costs.

Therefore, the Commission must abandon the attempt to make retroactive compensation adjustments, unless it is prepared to utilize a retroactive compensation rate exceeding $.35 per call.

APCC stresses that it is addressing only the issue of retroactive adjustment of independent PSPs' compensation for the Interim Period and the Second Report and Order Period. APCC recognizes that the RBOCs have taken a different position with respect to retroactive compensation. It would be both feasible and reasonable for the Commission to issue separate rulings with respect to independent payphones and ILEC payphones, in the

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[8] Since issuing the *Third Report and Order*, the Commission has received further evidence that uncollectables are indeed massive. RBOC/GTE/SNET Coalition Petition for Clarification, NSD File No. L-99-34, filed February 26, 1999, at 2-3. RBOC/GTE/SNET Coalition Reply Comments, filed June 1, 1999, at 5-6. Letter to Magalie Roman Salas from Robert F. Aldrich, July 28, 2000.

event that the Commission decides that the equities warrant retroactive adjustment of the compensation received for ILEC payphones.[9]

Sincerely,

Albert H. Kramer
Robert F. Aldrich

[9] For example, independent PSPs went uncompensated for subscriber 800 calls (the bulk of dial-around calls) for four years, due to the Commission's erroneous interpretation of the prior payphone compensation provision, Section 226(e)(2) of the Act. *See Florida Public Telecommunication Ass'n v. FCC*, 54 F.3d 857 (D.C. Civ. 1995). During that same period, LECs fully recovered their payphone costs because their payphones were part of the regulated rate base.

APCCS 1998 Dial Around Compensation Breakdown

Year	Qtr	Unique Submitted ANIs	Collections Per ANI Per Month	Compen-sated Calls Per ANI Per Month
1998	1	369,854	29	101
1998	2	389,149	33	115
1998	3	394,571	33	115
1998	4	373,135	30	104
1998	All	1,526,709	31	109

ATTACHMENT 2 TO
APCC EX PARTE LETTER OF
APRIL 15, 2002
RE STANDARDS FOR GRANTING
RETROACTIVE TRUE-UPS:

EXCERPTS FROM COLORADO
PAYPHONE ASSOCIATION
PETITION FOR RECONSIDERATION

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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OFFICE OF THE SECRETARY

In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996	CC Docket No. 96-128

PETITION OF THE COLORADO PAYPHONE ASSOCIATION FOR PARTIAL RECONSIDERATION

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April 21, 1999

the opportunity to resolve the impediments that currently inhibit the ability of payphone owners and carriers to negotiate fair compensation for dial-around calls." *Id.*, ¶ 18.

The IXCs, however, have no incentive to develop targeted call blocking. Currently, market rates for local coin calls are $.35, or more than 45% higher than the current dial-around compensation rate of $.24. The IXCs thus do not stand to gain from a move to a market-based approach. There is therefore no reason to believe that the carriers will go forward with implementing targeted call blocking absent an express Commission directive to do so.

If the Commission believes that targeted call blocking will open the way to the market-based approach to dial-around compensation that the Commission believes is correct, then the Commission must order the IXCs to implement the necessary technology as soon as possible. As the Commission found, "it will require a significant amount of time for IXCs to fully implement and deploy the necessary technologies." *Id.*, ¶ 18. The IXCs will not even begin the implementation process until they are ordered to do so. Thus, the longer the Commission delays in ordering targeted call blocking, the longer it will be before dial-around compensation can move to the market-based approach that the Commission has identified as the preferred approach.

III. THE COMMISSION ERRED IN REQUIRING PAYPHONE PROVIDERS TO REFUND A PORTION OF THE DIAL-AROUND REVENUE FOR THE PERIOD FROM OCTOBER 7, 1997 TO THE EFFECTIVE DATE OF THE *THIRD R&O*

The Commission should also reconsider its decision to order a true-up of the dial-around compensation amount paid to payphone providers during the period from October 1, 1997 to the effective date of the *Third R&O*. In cases where retroactive modification of rates is permissible, the Commission must decide whether to impose such retroactive remedies based on the equities underlying each case:

> [T]he [D.C. Circuit has] held that the standard of review of an agency refund order is *whether the agency decision is "equitable in the circumstances of this litigation."* The stress upon "equitable considerations," indicates that, while the agency has a duty to consider the relevant factors in making a refund decision and enjoys a broad discretion in weighing these factors, the precise manner in which these general principles should be applied by a reviewing court depends upon, as is traditional in cases sounding in equity, the facts of the particular case.

Las Cruces TV Cable v. FCC, 645 F.2d 1041, 1047-48 (D.C. Cir. 1981) (quoting *Wisconsin Elec. Power Co. v. FERC*, 602 F.2d 452, 457 (D.C. Cir. 1979)). As the court noted in remanding the proceeding to the Commission, the "Commission itself has acknowledged that it has the authority to adjust the compensation rate retroactively, '*should the equities so dictate*.'" *MCI v. FCC*, 143 F.3d 606, 609 (D.C. Cir. 1998) (emphasis added) (citations omitted).

In *Towns of Concord*, the D.C. Circuit clarified that there is no presumption in favor of retroactive refunds or surcharges and, in fact, that equity generally disfavors the imposition of retroactive refunds:

> Customer refunds are a form of equitable relief, akin to restitution, and the general rule is that agencies should order restitution *only when "money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it.*"

Towns of Concord v. FERC, 955 F.2d 67, 75 (D.C. Cir. 1991) (emphasis added) (quoting *Atlantic Coast Line R.R. v. Florida*, 295 U.S. 301, 309 (1935)). The Commission recently adopted the *Towns of Concord* decision, holding that "[j]ust as FERC has discretion to consider matters of equity in ordering refunds under the Federal Power Act, we have discretion to consider matters of equity under the Communications Act." *In the Matter of Investigation of Special Access Tariffs of Local Exch. Carriers*, 6 Comm. Reg. 555, 607 (1997) (citing *Towns of Concord*, 955 F.2d at 72; *Las Cruces*, 645 F.2d at 1046-48).

Here, however, the Commission ordered the true-up without first engaging in a balancing of the equities. Had the Commission evaluated the equities, it would have concluded that requiring a refund was inappropriate.

The current proceeding is an outgrowth of Docket No. 91-35, in which the Commission erroneously failed to award independent PSPs compensation for subscriber 800 calls. In that initial payphone compensation decision, the Commission erred in interpreting TOCSIA's mandate to "consider the need to prescribe compensation" for independent PSPs as applicable only to access code calls, not to subscriber 800 calls. After several years of delay (granted at the behest of IXCs and the Commission based on allegedly related reconsideration proceedings), the court of appeals finally heard APCC's appeal of the Commission's ruling, and overturned it, holding that Section 226 did in fact authorize the Commission to prescribe subscriber 800 compensation. Congress then confirmed, by enacting Section 276, that PSPs were in fact entitled to compensation for subscriber 800 calls. *Florida Pub. Telecomms. Assoc. v. FCC*, 54 F.3d 857 (D.C. Cir. 1995) ("*FPTA*"). The Commission folded its proceeding on remand of *FPTA* into the present proceeding on Section 276. APCC then requested that the Commission take a modest step to recognize independent PSPs' entitlement to compensation under *FPTA* by making the interim compensation in this proceeding retroactive at least to the date of the Public Notice initiating this proceeding. The Commission rejected this request, stating only that compensation was being provided "as soon as practicable." *First R&O*, ¶ 126.

Given the Commission's decision in the *Third R&O* to reduce further the dial-around compensation amount, the IXCs can complain only that they paid too much compensation for, at most, about one year. Independent PSPs were deprived of *any* compensation for subscriber 800 calls (about 70% of compensable coinless calls) for *more than four years.* It cannot be equitable to require PSPs to give back any of the compensation they have received to date, when that compensation barely begins to make up for four years' worth of uncompensated subscriber 800 calls.

By contrast, a retroactive refund would bestow a windfall on the IXCs. Not only have the IXCs passed on the full cost of dial-around compensation to consumers through direct surcharges, the IXCs have also used a variety of other means to recover their costs that, in the aggregate, have resulted in a massive *over*-recovery for the IXCs'. Thus, rather than having been harmed by being required to pay dial-around compensation, the IXCs have actually benefited, by turning dial-around calls into a profit center.

The IXCs began passing on their dial-around costs as surcharges in December 1996. In December 1996, for example, Sprint revised its FCC Tariff No. 2 to add a $.15 per call Payphone Surcharge for "all Originating payphone traffic including FONCARD traffic, toll free switched and dedicated services traffic, Prepaid card service traffic, and 10CPA-0 Plus Dial-around service traffic" effective December 1, 1996.[8] Effective April 1, 1997, this charge jumped to $.35.[9] The other major carriers have put equivalent surcharges in place. *See* RBOC Coalition *ex parte* letter from Marie Breslin to Magalie Roman Salas (March 11, 1998), The Toll-Free Truth: Long Distance Companies Overcharge for Payphone Calls, 1, 3 ("Toll-Free Truth") (pertinent pages attached hereto as Exhibit 2). The amount of these surcharges often exceeded the $.24 rate in effect during the period in question. *See* APCC *ex parte* letter from Albert H. Kramer to Magalie Roman Salas (March 16, 1998), History of Payphone Compensation, 19 ("History of Payphone Compensation") (pertinent pages attached hereto as Exhibit 3). Thus, there is every reason to believe that the surcharges alone *more* than fully compensated the IXCs for their dial-around costs during the period in question.

On top of the surcharges, however, the IXCs, most notably AT&T, Sprint, and MCI have raised their rates for subscriber 800 and some interstate and international services in direct response to their dial-around compensation obligations. History of Payphone Compensation at 17; Toll-Free Truth at 1-6. AT&T, for example, increased interstate 800 rates by 3% in February 1997, allegedly to recover increased payphone costs.[10] MCI spread "increase[d] rates as a result of the Payphone Recovery Order" across some 21 categories of service, none of them seemingly related to payphone

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8 Sprint has estimated that its total monthly cost of paying its $4.97 share of the monthly $45.85 per payphone interim compensation to PSPs is $2.5 million, and it was recovering this new cost through the $.15 surcharge. *See* APCC's *Second R&O* Comments (Aug. 26, 1997), Attachment 5.

9 *See id.*, Attachment 7.

10 *See id.*, Attachment 8.

services. History of Payphone Compensation, 17. *See also* Toll-Free Truth, 6. These rate increases were over and above direct surcharges. According to a study performed by Frost & Sullivan, based on public information provided by AT&T, AT&T's rate increases *alone* totaled some $642 million in 1997. *See* RBOC Coalition *ex parte* letter from Marie Breslin to Magalie Roman Salas (March 11, 1998) (attaching Frost & Sullivan study re AT&T rate increases).

In addition to recovery from end users, the IXCs also benefited from $250,000,000 annually in payphone-specific reductions in interstate access charges paid to local exchange carriers ("LECs") as a result of the Commission's rules terminating all subsidies for the LECs' payphone operations. History of Payphone Compensation, 17. Substantial additional subsidies were also terminated at the state level. *Id.*

The IXCs have also received substantial cost savings as the result of the shift away from commissionable 0+ calls. From 1993 to 1997, the number of 0+ calls from the average payphone fell from 51 to 16 calls per month. *See* RBOC Coalition *ex parte* letter from Marie Breslin to Magalie Roman Salas (March 11, 1998) (attaching Frost & Sullivan study re IXC of cost savings). This 69% reduction has dramatically lowered the IXCs' payments to PSPs. The IXCs' total savings are approximately $372 million. *Id.*

The IXCs have not passed to their customers on any portion of their cost savings from the reductions in access charges and commissionable 0+ calls. Thus, even if the surcharges and rate increases taken together merely resulted in the IXCs covering their costs—which is not the case—the IXCs have actually over-recovered by *at least*

$622,000,000 per year in cost savings alone. When the excess surcharges and rate increases are factored in, it becomes apparent that the IXCs have had *at least* a double recovery of their costs. In light of this, the Commission cannot find that a balancing of the equities permits the IXCs to receive a refund and thus increase their already inordinate over-recovery.

CONCLUSION

The Commission should partially reconsider the *Third R&O* as discussed above.

Respectfully submitted,

Craig D. Joyce /jsf

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Dated: April 21, 1999

EXHIBIT 2 TO EXCERPTS FROM COLORADO PAYPHONE ASSOCIATION PETITION FOR RECONSIDERATION

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Marie T. Breslin
Director
Government Relations - FCC

EX PARTE OR LATE FILED

Bell Atlantic

March 11, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

EX PARTE

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket 96-128, Pay Telephone Reclassification and Compensation

On March 10, 1998, Aaron Panner of Kellogg, Huber, Hansen, Todd and Evans and the undersigned, representing the RBOC/GTE/SNET Payphone Coalition, met with Glenn Reynolds of the Common Carrier Bureau.

The purpose of the meeting was to explain the attached materials developed by the Payphone Communications Alliance. Also provided were the attached study materials prepared by Frost and Sullivan to quantify IXC rate increases, savings in payphone commission payments and payphone-related access charge reductions.

Please call me if you have any questions concerning this material.

Sincerely,

Marie Breslin

Attachments

cc: G. Reynolds

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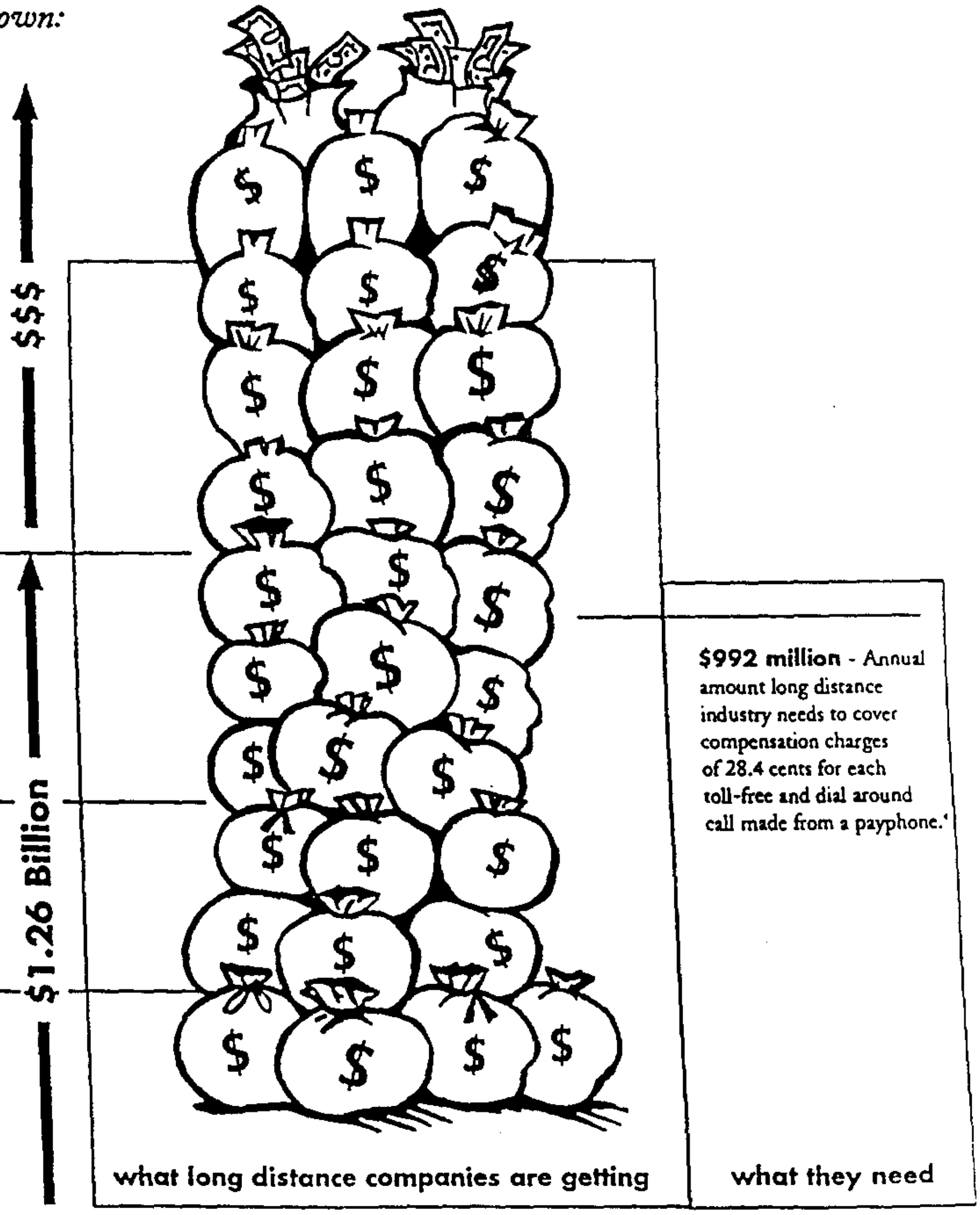
The Toll-Free Truth:

Long Distance Companies Overcharge for Payphone Calls

Long distance companies are charging consumers hundreds of millions of dollars more than necessary to compensate payphone providers for toll-free and dial around calls. Here's the breakdown:



$$$ - In 1997, AT&T, MCI, Sprint and other long distance companies began imposing millions of dollars in surcharges -- up to 30 cents per call -- on all dial around and toll-free calls made from payphones. These surcharges alone will recover any amounts paid to payphone providers.

$$$ - Amount gained by MCI, Sprint and some other long distance companies from rate increases attributed to payphone compensation.

$641.6 million - Amount gained *by AT&T alone* in 1997 from rate increases on toll-free, business long distance and credit-card calls. AT&T imposed the hikes explicitly to compensate payphone providers.[1]

$371.5 million - Amount saved by long distance companies in 1997 in commission payments to location owners and payphone service providers.[2]

$250 million - Annual amount saved by long distance companies from elimination of interstate subsidies for payphone services provided by local phone companies[3]

$992 million - Annual amount long distance industry needs to cover compensation charges of 28.4 cents for each toll-free and dial around call made from a payphone.[4]

Sources:

1 *Frost & Sullivan. Total amount is for AT&T rate hikes in February and May and does not include rate increases imposed by MCI, Sprint and other long distance carriers in 1997. On an annualized basis, the AT&T increases would exceed $900 million.*

2 *Based on public data and data submitted by payphone providers and independently verified and validated by Frost & Sullivan*

3 *Federal Communications Commission*

4 *Frost & Sullivan analysis based on FCC data*

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THE TOLL-FREE TRUTH

The Situation

- Section 276 of the Telecommunications Act of 1996 requires that payphone service providers (PSPs) be *"fairly compensated for each and every completed... call"* made from a payphone. This provision ended the free ride that long distance companies enjoyed, paying little or nothing for millions of calls made from payphones.

- These calls fall into two categories: (1) "access code," or "dial around," calls that give the caller the ability to choose a particular long distance service (these include, for example, 10XXX calls such as "10321," as well as 1-800-COLLECT and 1-800-CALLATT); or (2) "subscriber-800," or "toll-free," calls that permit a caller to reach a toll-free number obtained from a long distance company ("800" or "888").

- In April of 1997, the local telephone companies reduced their federal access charges to long distance carriers (the fees long distance companies pay to originate and/or terminate long distance calls on local telephone networks) by more than $250 million per year, specifically to reflect the reduction in costs from the elimination of payphone subsidies as directed by Congress in Section 276 of the Act.

- In October of 1997, the FCC established a charge of 28.4 cents per call for dial around and toll-free calls made from payphones. *Long distance companies, not end users, are responsible for paying the PSPs this charge.*

- The FCC set the per-call charge for these calls based on the prevailing deregulated rate for a local call made from a payphone (local coin call), less the costs the FCC identified as avoided when a caller places a dial around or toll-free call from a payphone.

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THE FACTS

✓ Despite some recent reports to the contrary, payphone <u>users</u> are not charged at the payphone for toll-free and dial around calls.

✓ *In a recent consumer information bulletin, the Commission said, "Long distance companies have significant leeway on how to compensate PSPs. The FCC left it to each long distance company to determine how it will recover the cost of compensating PSPs."*

✓ The truth is that some long distance companies have used the FCC's payphone proceeding as an excuse to overcharge their customers.

✓ The total benefit accrued by long distance companies from rate increases, access charge and commission savings reductions is more than enough to cover payphone compensation.

⇒ Over the last year, long distance companies have imposed several across-the-board increases in their toll-free rates, each time asserting that the increase was for the explicit purpose of covering PSP compensation for toll-free and dial around calls from payphones.

⇒ Long distance companies have pocketed more than $250 million a year in recurring savings, specifically due to elimination of payphone subsidies.

⇒ Long distance companies have saved tens of millions of dollars in commissions to PSPs and payphone location owners as a result of the massive shift from 0+ calls to dial around calls made possible by changes in federal law in 1992, the Telephone Operator Service Improvement Act ("TOCSIA"). For example, AT&T paid commissions of up to 95 cents per call for each 0+ call received from a payphone. By shifting 0+ calls to the heavily advertised "1-800-CALL ATT," AT&T used the technological loophole to reap huge savings and profit.

✓ The new per-call charge that long distance companies imposed last fall (AT&T - 28 cents; MCI and Sprint - 30 cents) on their toll-free and credit card subscribers is entirely unjustified since these companies have already more than recovered the cost of the FCC's payphone decision. These new, additional per-call charges are creating a windfall for long distance companies and a backlash from toll-free subscribers and consumers against a proper and fair decision by the FCC.

Payphone
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BRIEF BACKGROUND

General

On February 8, 1996, the President signed into law the Telecommunications Act of 1996 ("Act"). Passage of the Act was critical to the future success and growth of the U.S. payphone industry. For decades, government regulation kept the price of a local payphone call artificially low.

Section 276 of the Telecommunications Act of 1996 was designed to level the playing field in the payphone industry to promote competition among all payphone service providers (PSPs), telephone companies and independents, and the widespread deployment of payphone services.[1] It requires that all PSPs be *"fairly compensated for each and every completed... call"* made from their payphones, and it gives the FCC the responsibility of ensuring that this requirement is met. This compensation requirement is particularly important since as much as one-half to two-thirds of long distance calls from payphones have shifted to dial around and toll-free calls.[2] Section 276 also directs the FCC to ensure that all payphone subsidies are eliminated.

FCC's First Set of Rules
Per-Call Compensation Set at 35 Cents

On September 20, 1996, the FCC adopted its first set of rules implementing Section 276 of the Act. It deregulated local coin rates in all 50 states, effective October 7, 1997, and it directed the local telephone

---

[1] There are about 2 million payphones in the United States. Approximately 80 percent are owned by local telephone companies or their affiliates. Independent payphone companies own the rest.
[2] "Access code," or "dial around" calls give the caller the ability to choose a particular long distance service (these include, for example, 10XXX, such as "10321," as well as 1-800-COLLECT and 1-800-CALLATT). Subscriber-800," or "toll-free," calls permit a caller to reach a toll-free number obtained from a long distance company ("800" or "888").

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companies to eliminate payphone subsidies by April 15, 1997. For the first period – November 1996 to October 1997 – the FCC required that long distance companies with more than $100 million in revenues pay each PSP a flat rate per phone, apportioned among long distance companies by market share. In the second 12-month period (which has already begun), when per-call tracking is widely available, the FCC initially set a compensation rate of 35 cents per call, the prevailing rate for local coin calls in states where the rate for such calls is not regulated. The FCC reasoned that a long distance company should ultimately negotiate with PSPs for a per-call compensation rate.

FCC's Second Set of Rules
Per-Call Compensation Reduced to 28.4 Cents

On July 1, 1997, the U.S. Court of Appeals for the DC Circuit remanded the payphone compensation rate to the FCC for further consideration. On October 9, 1997, the FCC adopted a second set of rules, reducing the per-call compensation from 35 cents per call to 28.4 cents, over the objections of the PSPs. The FCC again concluded that "a market-based rate best responds to the competitive marketplace for payphones consistent with the deregulatory scheme...pursuant to Section 276, and will also effectively advance the statutory goals of encouraging competition and promoting the deployment of payphones."

Long Distance Companies Raise Rates
Using the FCC Rules as an Excuse to Overcharge Customers

Several long distance companies have asked the FCC to reconsider its October 9 decision. A decision from the FCC is anticipated by the spring of 1998.

These long distance companies are challenging the FCC rules despite the significant reduction in the per-call rate from 35 cents to 28.4 cents (nearly 20 percent). In the meantime, the long distance companies have repeatedly raised their toll-free rates purportedly to cover payphone compensation, added per-call surcharges (to cover the same payphone compensation) and pocketed in excess of $250 million in savings from the elimination of payphone subsidies.

AT&T, for example, raised its 800 rates at least three times in 1997 to pay for the new compensation rate.

- On February 27, AT&T raised rates for all toll-free calls by 3 percent and imposed a charge of 15 cents per call for business credit card calls.
- On May 1, AT&T raised its interstate toll-free rates by 7 percent and business international and interstate outbound services by 2 percent.
- *On June 1, AT&T added another 35-cent per-call charge for operator handled calls, including calling card calls "to offset payments to payphone owners."* This charge was reduced to 28 cents only after the FCC reduced the per-call charge in October 1997. The new 28 cent per call surcharge was expanded to include toll free calls.

MCI and Sprint have repeatedly raised their rates as well.

- *MCI raised its 800 rates twice in 1997*, each time by more than three percent.
- *Sprint also raised its 800 rates twice*, by two percent in November 1996, and again by about five percent in 1997.
- *MCI and Sprint also announced last year that they will impose $0.30 per call surcharge for payphone use.*

Even though AT&T, MCI and Sprint announced per-call rate hikes to cover the 28.4 cents, none have rolled back the substantial across-the-board rate increases they made earlier, specifically to cover payphone compensation.

Finally, since April 15, 1997 the long distance companies have also pocketed in excess of $250 million as a result of the elimination of payphone subsidies historically included in local telephone company access charges.[3] None of these savings have been passed on to consumers or to 800 service customers.

[3] Access charges are the charges long distance companies pay to local telephone companies for the origination and termination of long distance calls on the local telephone network.

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To: Jim Hawkins, Co-Chair of the Payphone Communications Alliance
Vince Sandusky, Co-Chair of the Payphone Communications Alliance
From: Brian Cotton
Date: February 26, 1998
Subject: Long-distance company commission savings

Dear Mr. Hawkins and Mr. Sandusky:

Please find attached a spreadsheet model depicting the long-distance companies' savings in commissions to Payphone Service Providers (PSPs) due to the shift from 0+ dialing to dial-around calling from payphones since 1993. This model assumes that the average number of 0+ calls from a payphone would have remained constant had the 1990 law which mandated equal access from payphones, not passed. *Our conclusion is that the long-distance companies, industry-wide, have saved a minimum of $371.5 million in commission payments in 1997 alone from paying less in commissions to PSPs, due to a shift from 0+ to dial-around calls from payphones.*

The estimate of the number of payphones installed in the U.S. market (1993-1997) is based on Local Exchange Carrier (LEC) reports to the Federal Communications Commission (1,694,000 in 1997), and an estimate of the number of independent payphones and payphones from LECs not required to be reported to the FCC (529,000 payphones in 1997). Note that our results for the industry-wide commission savings are conservative, since we used a conservative estimate of the number of payphones from independent and non-reporting LECs.

To explain this model in more detail, we first estimated the average number of 0+ calls made from a payphone in a month in a given year (C1), and multiplied it by the average commission paid for each 0+ call (M). We then multiplied this monthly figure by 12 months, and multiplied this result by the estimated number of payphones installed in the U.S. market in a given year (Q) to arrive at the total payphone commission paid by the long-distance companies (TC1).

Next, we assumed that the 1990 law had not been enacted. We conservatively estimated that the average number of 0+ calls from payphones remained constant at 51.02 for the analysis period (C2), and calculated the total payphone commission paid by the long-distance companies had the 1990 law not passed (TC2).

Finally, to calculate the amount of payphone commissions that the long-distance companies saved each year since the 1990 law was enacted (Savings), we subtracted the actual commission payments (TC1) from the baseline commissions (TC2). Thus in 1997 alone, the long-distance companies saved $371.5 million in payphone commissions.

To extrapolate from these figures, if the number of payphones installed continues to grow past 1997, the long-distance companies' savings should grow significantly.

Please do not hesitate to call me on my direct line (650-237-4315) if you have any questions about this material.

Sincerely,

Brian Cotton